

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Hollingsworth Analyst: Jane Tolman Bill Number: SB 417
Related Bills: See Legislative History Telephone: 845-6111 Introduced Date: 02-20-2003
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Exclusion/Qualified Civil Service Retirement Annuity Income

SUMMARY

This bill would exclude income from a federal civil service retirement annuity from income tax.

PURPOSE OF THE BILL

The purpose of this bill according to the author is to decrease the amount of tax paid by individuals living on certain types of retirement income.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would take effect immediately. It would apply to taxable years beginning on or after January 1, 2003.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Federal law generally taxes pensions, Individual Retirement Accounts (other than Roth IRAs), annuity plans, railroad retirement tier 2 benefits, and self-employed retirement plan benefits. Social Security and the equivalent tier 1 railroad retirement benefits can be partially taxable depending on the taxpayer's total income. Essentially, the higher the total taxable income, the greater the taxable part of the Social Security or equivalent tier 1 railroad retirement benefits.

California generally conforms to the federal laws taxing pensions, IRAs, annuities, and retirement income. However, California excludes from taxation any Social Security or tier 1 or 2 railroad retirement benefits.

Board Position:

| | | |
|-----------------------------|------------------------------|---|
| <input type="checkbox"/> S | <input type="checkbox"/> NA | <input type="checkbox"/> NP |
| <input type="checkbox"/> SA | <input type="checkbox"/> O | <input type="checkbox"/> NAR |
| <input type="checkbox"/> N | <input type="checkbox"/> OUA | <input checked="" type="checkbox"/> PENDING |

Department Director
Gerald H. Goldberg

Date
03/25/03

Under existing federal personnel law, there are two different retirement systems that provide retirement benefits to civilian employees. The first, known as the Civil Service Retirement System (CSRS), applies to federal employees hired before January 1, 1984. The second, known as the Federal Employee Retirement System, applies to new federal employees hired after December 31, 1983. The costs, eligibility requirements, and benefits of these two federal civilian retirement systems vary substantially.

THIS BILL

This bill would exclude from the calculation of gross income certain retirement annuity income attributable to federal civil service.

A “qualified civil service retirement annuity” means an annuity payable to an individual under provisions of the Civil Service Retirement System. The exclusion provided by the bill would not extend to an annuity payable to an individual under the Federal Employee Retirement System.

IMPLEMENTATION CONSIDERATIONS

Implementation of this bill would not significantly impact the department.

LEGISLATIVE HISTORY

AB 1887 (Hollingsworth, 2001–2002) would have decreased the amount of tax paid by individuals receiving certain types of retirement income. This bill failed to pass from the Assembly Revenue and Taxation Committee.

OTHER STATES’ INFORMATION

The states surveyed include *Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Illinois, Massachusetts, Minnesota, Michigan, and New York also exclude Social Security and tier 1 railroad retirement income from taxation, while taxing federal civil service retirement income.

FISCAL IMPACT

This bill would not significantly impact the department’s costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

| Revenue Impact Tax Years Beginning After December 31, 2002 Enactment Assumed After June 30, 2002 (\$ Millions) | | | |
|---|---------|---------|---------|
| Fiscal Year | 2003-04 | 2004-05 | 2005-06 |
| Federal Civil Service | -33 | -25 | -26 |

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

Revenue losses were estimated by the use of the personal income tax model to simulate the exemption of pension income. From national data, it is known that federal civil service retirement benefits compose 11% of all retirement annuities (public and private). This percentage was applied to the total amount of California taxable pension income projected by the tax model to derive an estimate. Of this amount, 9.9 % was attributable to CSRS annuitants.

ARGUMENTS/POLICY CONCERNS

There could be inequitable treatment provided by the bill for federal retirees (and survivors) depending on which retirement system applies to each individual's situation. There is also inequity compared with other federal retirees, i.e., military, as well as other government retirees, i.e., California state employees.

LEGISLATIVE STAFF CONTACT

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